

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

HEIGHTS AT ISSAQUAH RIDGE OWNERS  
ASSOCIATION, a Washington non profit  
corporation, as assignee of Derus Wakefield I,  
LLC, a Washington limited liability company, and  
Steven Derus,

Plaintiff,

v.

STEADFAST INSURANCE COMPANY, a  
Delaware Corporation, AND ZURICH  
AMERICAN INSURANCE COMPANY, a New  
York Corporation,

Defendants.

CASE NO. C07-1045RSM

ORDER ON MOTION TO COMPEL

This matter is now before the Court for consideration of plaintiff's motion to compel, Dkt. # 18. Plaintiff seeks to compel defendants to produce complete and unredacted copies of certain documents regarding loss reserves and reinsurance. Defendants have opposed the motion. The Court has fully considered the parties' memoranda and exhibits, and for the reasons below shall grant in part, and deny in part, the motion.

DISCUSSION

The facts of this matter are well-known to the parties and need not be set forth in detail. Briefly stated, this case arises from a construction-defect case litigated in King County Superior Court. The Heights at Issaquah Ridge Owners Association, plaintiff here, sued developer Derus Wakefield I, LLC ("Wakefield") regarding the construction defects. Defendant Steadfast Insurance Company

1 (“Steadfast”) had issued two commercial general liability policies to Derus Development Company.  
2 Plaintiff asserts that it is undisputed that Derus Wakefield was a named insured under one of the two  
3 policies, designated the “01” policy. Defendant Steadfast denied coverage to Wakefield under the other  
4 policy, the “00” policy. Plaintiff and Wakefield settled the state court action, and Steadfast paid the one  
5 million dollar policy limit under the “01” policy. In the settlement, Wakefield stipulated to entry of  
6 judgment against it and assigned its rights against Steadfast under the “00” policy to plaintiff. Steadfast  
7 has appealed the judgment in the state court action and that appeal is currently pending. Plaintiff in this  
8 action asserts Wakefield’s claims of bad faith, breach of contract, and Consumer Protection Act  
9 violations against Steadfast, as assignee under the settlement.

10 In this motion, plaintiff seeks to compel production of information regarding loss reserves and  
11 reinsurance that was redacted from the claims file information provided by Steadfast in discovery. This  
12 Court has ruled previously that neither loss reserves nor reinsurance is relevant to a bad faith claim, and  
13 that neither is discoverable. *Amazon.com, Inc., v. Atlantic Mutual Insurance Company*, C05-719 RSM,  
14 Dkt. # 264. Plaintiff argues that the Court should instead follow the ruling in *Lexington Insurance*  
15 *Company v. Swanson*, 240 F.R.D. 662 (W.D.Wa. 2007), in which loss reserve information was held to be  
16 relevant. *Id.* at 668.

17 In that ruling, the court stated that,

18 Washington courts have suggested that relevance is rarely a proper grounds in a bad faith  
19 case for refusing to produce documents contained in the insurer’s claims file *See, e.g.,*  
20 *Escalante v. Sentry Ins. Co.*, 49 Wn. App. 375, 393 n. 10 (1987), *disapproved of on other*  
21 *grounds by Ellwein v. Hartford Accident & Indem. Co.*, 142 Wn. 2d 766 (2001), (noting  
that “In general, the relevancy objections raised by [the insurer] . . . are meritless because  
the very nature of most bad faith actions makes most, if not all, of the insurer’s claims file  
relevant.”)

22 *Id.* The court also cited to the California case of *Lipton v. Superior Court of Los Angeles County*, 48  
23 Cal.App. 4th 1599 (1996), stating that

24 [t]he *Lipton* court held that reserve information was discoverable because such information would  
25 assist the plaintiff in evaluating his bad faith case and in preparing it for trial. The  
26 *Lipton* decision is consistent with other cases evaluating this issue. Indeed one treatise has  
observed that “[t]o this writer’s knowledge, no case has held that reserves evidence is  
irrelevant in a bad faith case.”

27 *Id.*, quoting Stephen S. Ashley, *Bad Faith Actions Liability & Damages* § 10:31 (2006). The Court has  
28 reviewed these authorities and has determined that they to not compel the same result here.

1 First of all, relevance is not a question that is determined by Washington (or California) law.  
 2 Questions of relevancy and admissibility of evidence in this diversity case are governed by the Federal  
 3 Rules of Evidence. *American Protection Insurance Company v. Helm Concentrates, Inc.*, 140 F.R.D.  
 4 448 (E.D.Cal. 1991). Pursuant to those rules, a party may obtain discovery of “any matter, not  
 5 privileged, that is relevant to the claim or defense of any party. . . .” F.R.Civ.P. 26(b)(1). One court has  
 6 noted recently that this language, amended in 2000, left the scope of discovery in federal litigation  
 7 narrower than it is under many state court rules. *Bernstein v. Travelers Insurance Company*, 447 F.  
 8 Supp. 2d 1100, 1102-03 (N.D.Cal. 2006).

9 When read in context, the statement quoted above, that “to this writer’s knowledge, no case has  
 10 held that reserves evidence is irrelevant in a bad faith case,” actually appears to express the writer’s  
 11 surprise that he could find no such case.<sup>1</sup> The quoted section of the treatise—which appears to be a  
 12 practice manual rather than a scholarly treatise—opens with the following paragraph:

13 The extent to which insurers sued for bad faith freely disclose information concerning their  
 14 reserves and allow reserves to be admitted into evidence without objection is surprising.  
 15 The admission of reserves information should raise strong concerns, both with regard to  
 the reliability and prejudicial effect of such evidence and with regard to the public policies  
 that reserves are intended to promote.

16 Stephen S. Ashley, *Bad Faith Actions Liability & Damages* § 10:31 (2006). The complete paragraph  
 17 bearing the above-quoted language regarding the writer’s inability to find cases holding reserve  
 18 information irrelevant states,

19 To this writer’s knowledge, no case has held that reserve evidence is irrelevant in a bad  
 20 faith case. One may find support for the irrelevancy objection, however, in cases holding  
 21 that reserves evidence is irrelevant to the issue whether a policy should be interpreted to  
 22 provide coverage. [FN 29]: *Leski, inc., v. Federal Ins. Co.*, 129 F.R.D. 99, 106 (D.N.J. 1989),  
 related reference, 736 F. Supp. 1331 (D.N.J. 1990) (“[T]he setting of reserves is performed  
 by claims personnel who know little about [the insured’s] policies. I find that the reserve  
 information is only tenuously relevant to whether insurance coverage exists in this matter  
 and this information is not discoverable at this time.”)

23 *Id.*

24 Under Washington law, reserves are required for an insurance company to conduct business in the  
 25 state. RCW 48.12 *et seq.* The purpose of the requirement, which is found in many states’ statutes, is to  
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 28 <sup>1</sup>By contrast, the author discussed several cases in which loss reserves were found irrelevant in the  
 context of a case involving insurance coverage.

1 ensure that there is adequate money available to pay claims. The setting of reserve amounts may be an  
2 accounting decision, made by claims personnel with no knowledge of the particulars of the insured's  
3 actual policies. *Leski v. Federal Insurance Co.*, 129 F.R.D. 99, 106 (D.N.J. 1989). As stated by a  
4 district court in California, a state with a similar statutory reserve requirement, "[t]he legislature and  
5 Insurance Commissioner establish reserve policy. For this reason alone, a reserve cannot accurately or  
6 fairly be equated with an admission of liability or the value of any particular claim." *In re Couch*, 80  
7 B.N.R. 512, 517 (S.D.Ca. 1987); citing *Union Carbide v. Travelers Indemnity Company*, 61 F.R.D. 411,  
8 413 (W.D.Pa. 1973). The district court thus reversed the bankruptcy court's ruling allowing discovery  
9 of insurance reserves. *Id.*

10 Plaintiff asserts that defendants' reliance on *In re Couch* is misplaced, because "California courts  
11 now hold that reserve information is discoverable because such information will assist a plaintiff in  
12 evaluating a bad faith case and in preparing for trial." Plaintiff's Reply, Dkt. # 25, p. 3; citing *Lipton v.*  
13 *Superior Court of Los Angeles County*, 48 Cal. App. 4th at 1616. S However, the rule in *Lipton* is not  
14 nearly as broad or certain as plaintiff represents. Instead, the *Lipton* court "refus[ed] to adopt a *per se*  
15 rule of 'discovery irrelevance'" and "reject[ed] the conclusion that information related to the reserves a  
16 carrier designated on a particular claim could never be discoverable in a bad faith case." *Bernstein v.*  
17 *Travelers Insurance Company*, 447 F. Supp. 2d 1100, 1106 (N.D. Ca. 2006). Thus, rather than flatly  
18 stating that loss reserves are relevant in a bad faith action, the *Lipton* court declared that loss reserve  
19 information "**may or may not be relevant** in a subsequent bad faith action, depending on the issues  
20 presented." *Lipton*, 48 Cal.App. at 1614 (emphasis added). Thus, the relevance of the requested  
21 information must be tied to the specific issues presented, and the issue determined on a case-by-case  
22 basis.

23 *Lipton* was decided under California state discovery rules, which allow discovery of "any matter,  
24 not privileged, that is relevant to the subject matter involved in the pending action . . . " *Id.* at 1611;  
25 citing Cal. Code Civ. Proc. § 2017(a). The scope of discovery under the Federal Rules of Civil  
26 Procedure, allowing discovery of "any matter, not privileged, that is relevant to the claim or defense of  
27 any party . . . ," is narrower. F.R.Civ.Proc. 26(b)(1); *Bernstein*, 447 F. Supp. 2d at 1103.

28 Plaintiff here has asserted claims of bad faith, breach of contract, and violation of the Washington

Consumer Protection Act. A claim of bad faith in Washington is not easy to establish--- the insured has a heavy burden to meet. *Overton v. Consolidated Insurance Co.*, 145 Wash. 2d 417, 433 (2002) (citing *Ellwein v. Hartford Accident & Indemnity Co.*, 142 Wash. 2d 766, 775 (2001)).

To succeed, the insured must show the insured's breach of the insurance contract was "unreasonable, frivolous, or unfounded." If the insurer's denial of coverage is based on a reasonable interpretation of the insurance policy, there is no action for bad faith.

*Id.* (quoting *Kirk v. Mt. Airy Insurance Company*, 134 Wash. 2d 558, 560 (1998)). In moving to compel disclosure of loss reserves, plaintiff has not asserted how such information would be relevant to the claim of bad faith or to what plaintiff must establish in order to prevail on that claim. Nor has plaintiff asserted how the loss reserve information would be relevant to establish any element of a Consumer Protection Act claim.<sup>2</sup> The motion to compel information on loss reserves is accordingly DENIED.

Plaintiff has also moved to compel discovery of reinsurance policies and related communications. With respect to reinsurance, the policies themselves are discoverable under rule 26(a)(1)(D). *Great Lakes Dredge and Dock Co. v. Commercial Union Assurance Co.*, 159 F.R.D. 502, 504 (N.D.Ill. 1995). The rule is absolute, and does not require a showing of relevance. *United States Fire Insurance Company v. Bunge North America*, 244 F.R.D. 638, 641 (D.Kan. 2007); citing *National Union Fire Insurance Co. of Pittsburgh v. Continental Illinois Corp.*, 116 F.R.D. 78, 83-84 (N.D.Ill. 1987). The rule does not, however, extend to communications between insured and reinsurer regarding the reinsurance policies. *Excelsior College v. Frye*, 233 F.R.D. 583, 585 (S.D.Cal. 2006). To obtain discovery of those communications, plaintiff must demonstrate their relevance to the bad faith claim.

One court has cleverly explained the reason why reinsurance matters are rarely relevant to a claim of bad faith:

Underwriters' purchase of reinsurance may show their subjective belief or intention, but it does not mean a primary insurance policy was in effect. [FN 1]. If, however, other evidence supports plaintiff's position that the policy was in effect, reinsurance in the face of denial of coverage might suggest bad faith. [Plaintiff] also believes bad faith would be demonstrated

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<sup>2</sup> Those elements, if not established *per se* through a violation of the insurance code, are as follows: (1) the action complained of is an unfair or deceptive act or practice; (2) the action occurred in the conduct of trade or commerce; (3) there is a public interest component to the conduct; (4) there was injury to the plaintiff's business or property; and (5) there is a causal link between the unfair act and the injury suffered. *Nordstrom, Inc., v. Tampourlos*, 107 Wash. 2d 735, 739 (1987); citing *Hangman Ridge Training Stables, Inc., v. Safeco Title Insurance Co.*, 106 Wash. 2d 778, 780 (1986).

1 with the opposite outcome—lack of reinsurance. That hay could be made from either outcome  
2 is probably the best demonstration that the probative value of this information is little.

3 FN 1: Reinsurance agreements, which at best reflect an undisclosed unilateral intention, are  
4 irrelevant to determining the intent of the parties to the primary insurance contract. Thus,  
they would be non-discoverable, even were a finding of ambiguity made. *Rhone-Poulenc*, 139  
F.R.D. at 611-612.

5 *Great Lakes Dredge and Dock Company v. Commercial Union Assurance Company*, 159 F.R.D. 502,  
6 504 (N.D. Ill. 1995); citing *Rhone-Poulenc Rorer, Inc., v. Home Indemnity Co.*, 139 F.R.D. 609, 611-12  
7 (E.D.Pa 1991).

8 Reinsurance involves an insurance company's effort to spread the burden of indemnification.  
9 *Leski*, 129 F.R.D. at 106. It is a decision based on business decisions and not questions of policy  
10 interpretation. *Id.* This is particularly so when the reinsurance is treaty insurance, as it is here. Under a  
11 reinsurance treaty, the reinsurer agrees to accept an entire block of business from the insured. *North*  
12 *River Insurance Co. v. Cigna Reinsurance Co.*, 52 F. 3d 1194, 1199 (3rd Cir. 1995). There is no  
13 connection between the claims asserted against defendant Steadfast, and Steadfast's reinsurance of a  
14 block of its insurance policies, that would make that reinsurance relevant to the claims asserted here.

15 Plaintiff's motion to compel discovery of reinsurance documents is therefore GRANTED as to the  
16 policies themselves, pursuant to F.R.Cvi.Proc. 26(a)(1)(D), but DENIED as to all other reinsurance  
17 documents, including communications.

18 DATED this 13<sup>th</sup> day of December 2007.

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21 RICARDO S. MARTINEZ  
22 UNITED STATES DISTRICT JUDGE  
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